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Advanced CorporateFinanceFinal Case: Roche 1 2 Reasons for Roche's 100% ownership of Genentech Since Roche and Genentech both operate in the pharmaceutical industry, but still have their own specialty, they can benefit from a partnership. Roche owns a majority stake in Genentech since 1990 and since 2007, it owns 56% of Genentech. Genentech was founded in 1976, their focus lies on biotechnology in which they are the second largest firm of the world. Genentech had become an important part of Roche's business representing 24% of Roche's pharmaceutical product sales in 2008.

In July 2008, Roche made public that they'd want to acquire the remaining 44% of Genentech. For Roche this acquisition beholds several benefits, but of course also several risks. These benefits and risk are stated below. Benefits First of all since Genentech, in terms of revenue, is the second largest firm in biotechnology in 2007, a full acquisition will strengthen the market positions of both companies. Genentech experiences an expanding growth in sales (see exhibit B), so both companies notice more and more direct competition of each other in several U.

S. markets. A merger of Roche and Genentech would take away the direct competition and create new opportunities and strengths which would give them the opportunity to excessively work together on a world wide scale. Secondly, the acquisition beholds a great cost reduction. Roche managers believed there was increasing duplication of effort and facilities at the two companies and, thus, opportunities to create value by cutting costs and streamlining operations.

They identified that annual savings realizable over five years would be between $750 million and $850 million, most of which would be in manufacturing, General &Administrative and commercial operations. Another benefit of Roche owning 100%, a merge of the two companies would give Roche access to all the intelligence of Genentech. The concerns about property rights blocked the flow of information between researchers at the two companies. By the merge, they can share their intellectual property, which might facilitate product development and research.

Thus the constraint between Roche's and Genentech's R&D efforts would disappear. Since the R&D pipeline of Genentech grew stronger by the day in the ten years before the announcement (see exhibit A, B and C), a merge would be a big advantage to Roche. Finally, since the beginning of 2007, the free cash flow of Genentech grew largely. Roche could not access Genentech's cash directly under the present ownership structure. If a merge occurred, Roche would gain full access to the cash of Genentech.

Because expectations are that Genentech's cash flow will remain high, full access to this cash would have many advantages to Roche, like repaying the debt made by the acquisition. Risks Besides the benefits, there are also several risks involved with the takeover. First, the takeover would cost $44 billion, which partially would have to be loaned. The management wasn't sure that Roche would be able to raise the required debt funding given the state of the financial markets. In the middle of the financial crisis, banks weren't very keen in arranging bridge loans to finance such acquisitions.

As a result of this, even if they were able to manage in getting a bridge loan, this would be very expensive. Secondly, it is very hard to value the benefits to Roche in taking over Genentech. One of the causes of a misvaluation is that synergies tend to be mispriced. On top of that, Genentech was waiting on test results of their cancer drug Avastin, wich were to be expected in April 2009. If the acquisition would take place before this date, Roche bears the risk that the drug is rejected. Which would result in a drop in value of Genentech.

The risk that Roche takes by waiting on the test results is that, if the test results tend to be positive, stock price of Genentech would increase, making a deal substantially more expensive and thus making it even harder to finance it. Finally, there is a big chance of losing a lot of the human capital of Genentech. Genentech has become famous for its strong workingculture. This is partially because of the fact that most of the minority shareholders are Genentech employees. By taking over Genentech, Roche risks destroying the old culture and as a result, losing the employees to other firms.

Acquisition of Genentech by Roche would bring synergies to both companies. The several risks that are involved, are mostly being compensated by the benefits to Roche. The high debt can be repaid by the large amount of cash of Genentech, the risk brought by the uncertainty of the test results can be reduced by letting independent firms estimate Genentech's stand alone value, and the employees can be compensated for the loss of their share in Genentech in another way, e. g. by developing a strategy which maintains the important current working culture. Both companies would increase in strength